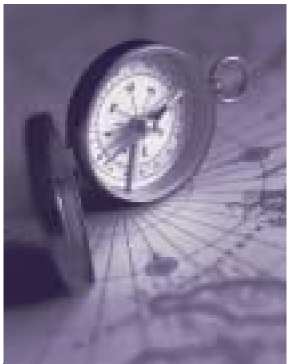

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Market Solutions • Litigation Support

TECHNICAL DOCUMENTATION

REPORT ON DECLINE IN CLEC MARKET CAPITALIZATION

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EXECUTIVE SUMMARY

The relative financial strength of the key companies in the telecommunications industry has changed dramatically over the last 30 months, from December 31, 1999 to August 28, 2002. Once high-flying new entrants are either bankrupt or a mere shell of their operations during the high growth period of the competitive local exchange segment of the telecommunications industry.

INTRODUCTION

This `Technical Document` is provided by QSI Consulting ("QSI") to highlight the tremendous decline in the market value of the competitive telecommunications industry since the end of 1999. This market capitalization analysis calculates the dramatic change in market value of the CLEC industry over the period of December 31, 1999 through August 28, 2002, based on the value of the common shares held by investors. For the IXC, CLEC and carrier's carrier segments, the total decline in market capitalization over this period is a staggering *$554 billion, or* ***88%***.[1] The data for just CLECs, excluding IXCs and carrier's carriers, is *$158 billion, or 91%.*

I. DESCRIPTION OF ANALYSIS

QSI created an analysis of 44 companies which comprise the vast majority of publicly traded CLECs and the four RBOCs to demonstrate the disparate financial strength of new entrants versus incumbent carriers. Market capitalization as of December 31, 1999 was used as the baseline value in this analysis for two primary reasons: (1) this point in time was still within the bull market period before the first significant market correction took place in the first quarter of 2000; and (2) the components necessary to calculate market capitalization, common shares outstanding and market price, were both readily available from publicly available sources such as websites that provide current and historical price quotes and Securities Exchange Commission ("SEC") filings.

The companies included in the analysis were classified into three categories:

(1) CLECs & Wholesale Suppliers

This category includes CLECs and wholesale suppliers. Not included are the CLEC divisions of the major IXCs – they are included in the third category described below. (The companies included in this category are identified in Attachment 1.)

(2) RBOCs

This category includes the four RBOCs: Qwest, SBC, BellSouth, and Verizon.

(3) Major IXCs – CLECs and Carrier's Carriers

[1] Table 1 summarizes the change in market capitalization for CLECs, RBOCs and IXCs. Attachment 1 provides a detailed calculation for each company included in the analysis.

This category includes the major IXCs: Williams Communications, Level 3 Communications, Global Crossing, Sprint, WorldCom, and AT&T.

These categories mirror the groups of companies that are compared and contrasted within the Kellogg-Huber Report of April 5, 2001, *Competition for Special Access Service, High Capacity Loops, and Interoffice Transport*, attached to the petition filed by Verizon, SBC and BellSouth before the FCC to be relieved of their obligations to provide unbundled access to high-capacity facilities.[2] Major IXCs such as AT&T, WorldCom, Sprint, Level 3, Williams and Global Crossing that also operate as CLECs and carrier's carriers were separated from the CLECs & Wholesale Suppliers category because the nature and scope of their operations are quite different from the other CLECs.

The Debt to Equity ratio was also determined for each company over the same time period to measure changes in relative financial strength based on the amount of debt used to fund operations versus stockholder's equity. Large ratios or ratios that increase over time indicate declining financial strength as debt becomes a larger component of the firm's capital structure. This can be attributed to a greater use of debt as equity markets dry up, declining stockholder's equity as a result of accumulated operating deficits, or a combination of both.

II. DISCUSSION OF ANALYSIS

The analysis demonstrates that the competitive carriers have suffered serious financial setbacks over the last two and one-half years. The decline in market capitalization for the three categories, CLECs & Wholesale providers, RBOCs and Major IXCs, is summarized as follows:

TABLE 1

CATEGORY	DECLINE IN MARKET CAPITALIZATION	% DECLINE IN MARKET CAPITALIZATION
Category 1: CLECs & Wholesale Providers	$ (157.6) Billion	- 91%
Category 2: RBOCs	$ (271.3) Billion	- 55%
Category 3: Major IXC - CLEC / Carrier's Carrier	$ (396.1) Billion	- 87%

A more detailed breakdown of the decline in market capitalization for these three categories of carriers is found in Attachment 1. The summary results are illustrated in Charts 1 – 4 below. Charts 1 and 2 compare the decline in market capitalization among the three company categories on both a dollar and percentage basis. Charts 3 and 4 depict the

[2] See *Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport*, CC Docket No. 96- 98, DA 01-911, April, 2001.

increasing dominance of the RBOCs as their market capitalization accounts for a greater share of the overall competitive telecommunications industry market capitalization.

CHART 1

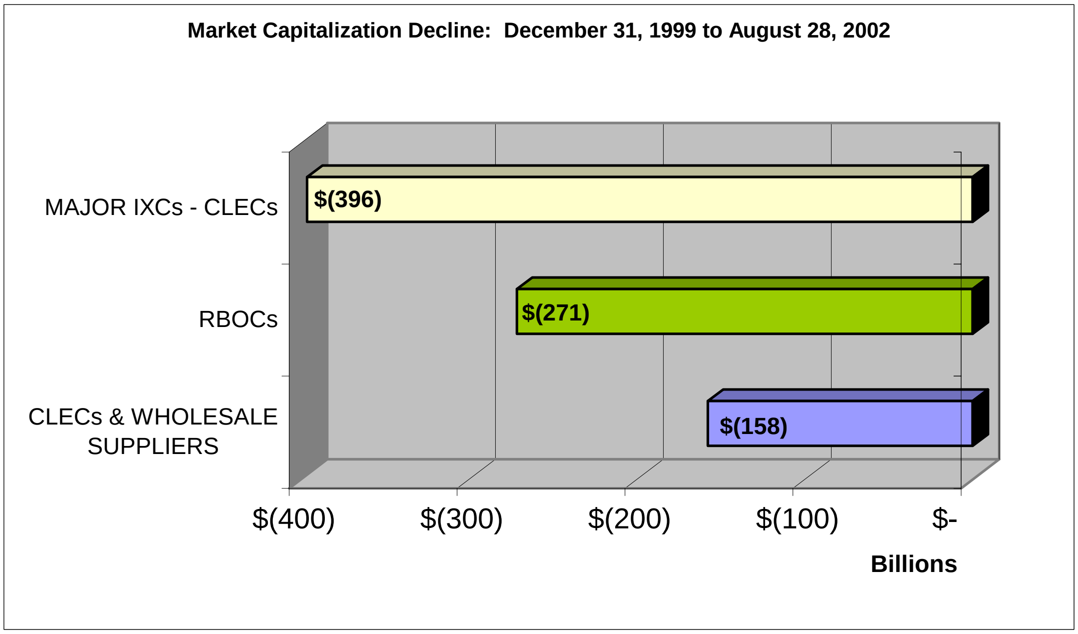
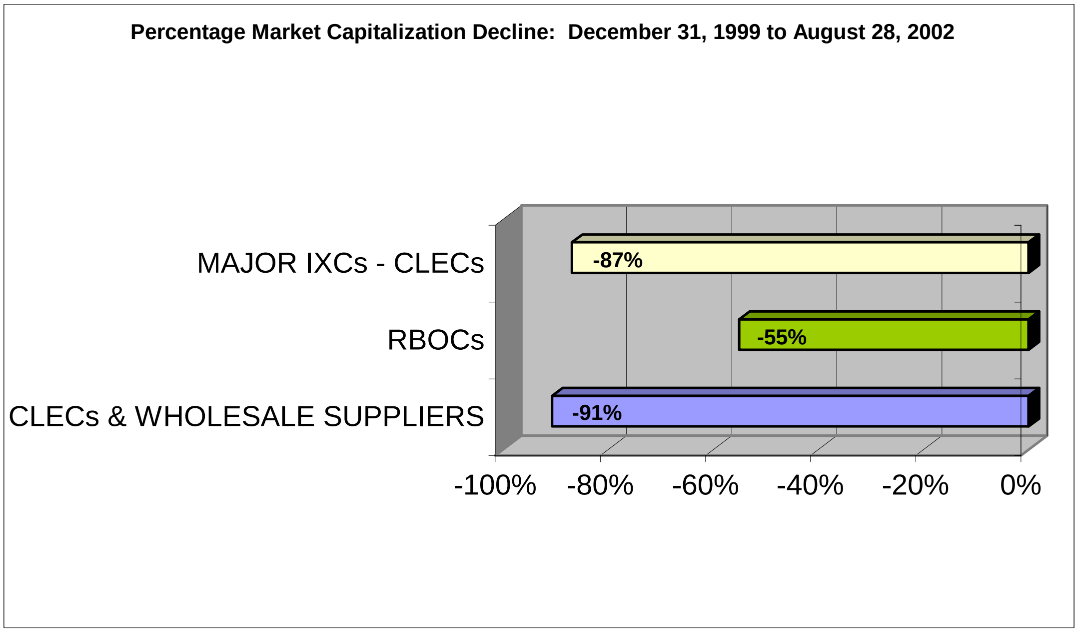


CHART 2



Since the market capitalization decline of the CLECs and IXCs is significantly greater than for the RBOCs, the relative value of each group to the total of the three groups combined has also changed dramatically. The following pie charts illustrate the increasing relative financial strength of the RBOCs over the last 32 months:

CHART 3

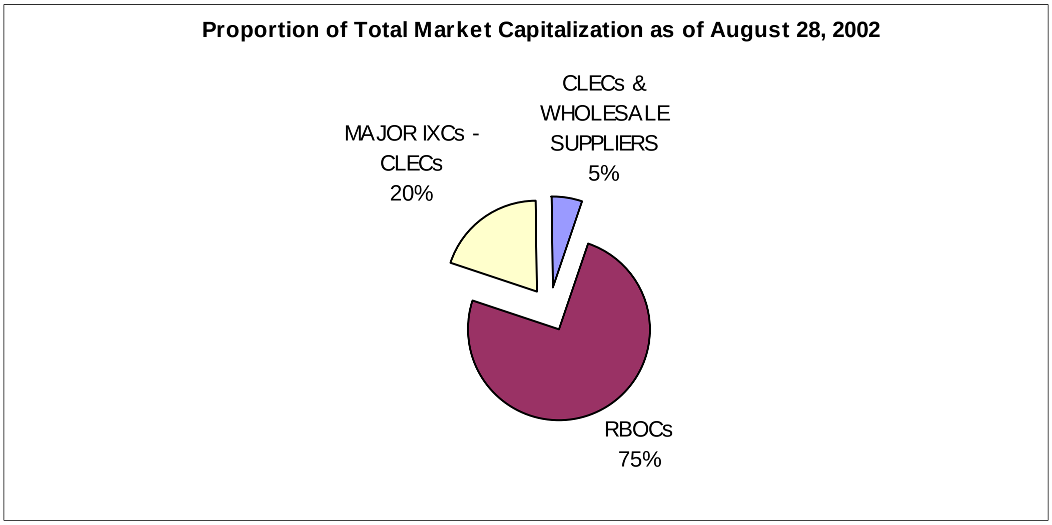
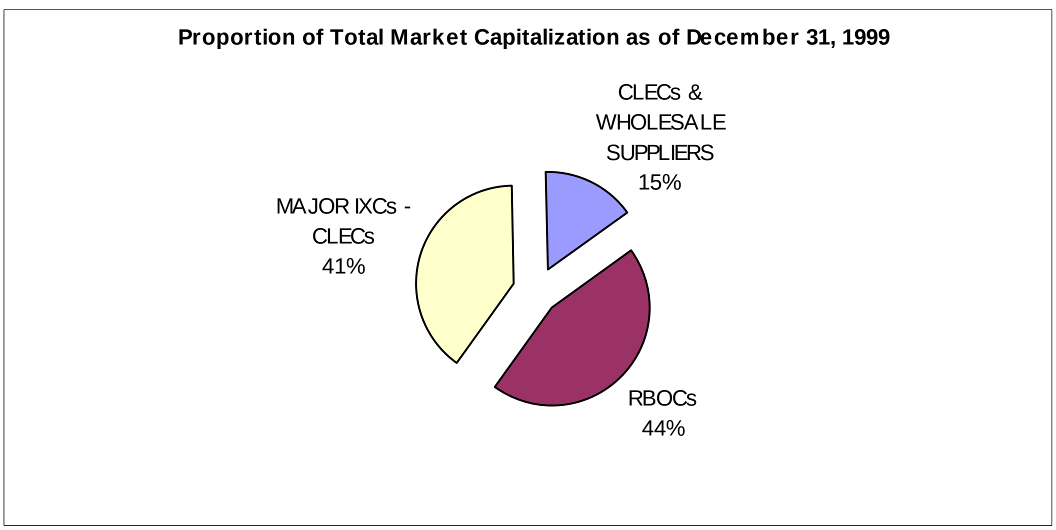


CHART 4



It is clear from Charts 3 and 4 that the financial strength of the remaining four RBOCs is increasingly dominating the telecommunications industry as their share of total market capitalization has nearly doubled.

III. IMPACT OF BANKRUPTCY FILINGS

Of the 40 companies comprising the CLEC and IXC categories (Categories 1 and 3), 18 have filed for bankruptcy protection since December 31, 1999 with seven of these filings occurring in the last six months.[3] A few of the carriers that initially filed for protection have since closed down their operations and sold off their assets to competitors. The number of CLECs and IXCs that have reported negative stockholders' equity due to accumulated operating deficits increased to 28 as of August 28, 2002 compared to eight as of December 31, 1999.[4]

Some of the reasons for the numerous bankruptcy filings include decline in demand, over-investment, large debt burdens, aggressive business expansion, and questionable accounting practices. However, one cannot overlook the impact that RBOC anti-competitive behavior has had on CLEC cash flow and profitability. CLECs have (1) spent a tremendous amount of time and money on litigating provisions of the Telecommunications Act of 1996 and subsequent FCC orders, (2) faced excessive prices for the critical network elements and central office space required to provide local exchange service, and (3) experienced significant delays in achieving the critical mass necessary to pay for the investment required to operate a telecommunications network due to inadequate RBOC operational support systems and RBOC claims of facility exhaust.

While it is conceivable that a company filing for protection under Chapter 11 of the bankruptcy code will improve its balance sheet after shedding debt and restructuring its operations, the equity investment community may no longer support this company after losing their previous investment in the bankruptcy filing. Two CLECs that have emerged from bankruptcy protection, McLeod and Covad, have yet to see any significant rebound in their stock price. Both are trading at less than 2% of their closing price on December 31, 1999.[5]

IV. VIEWS OF THE FINANCIAL MEDIA

The collapse in market value of the competitive telecommunications industry, including long distance, which is apparent from the financial data, has been duly noted by the financial community and the press. Not a day goes by without some pundit or another commenting on the dismal state of telecommunications competition. As one analyst concludes:

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3 See detailed listing of bankruptcy filing dates on Attachment 1.

4 The 28 carriers with Stockholder's Deficits as of August 28, 2002 include carriers that have filed for bankruptcy since December 31, 1999.

5 See Attachment 1 to this Technical Document. McLeodUSA closed at $0.39 per share for a market capitalization of $63.4 million as of August 28, 2002 compared to a share price of $58.88 and market capitalization of $27.8 billion as of December 31, 1999. Covad closed at $1.06 per share for a market capitalization of $233.6 million as of August 28, 2002 versus a share price of $55.94 and market capitalization of $5.3 billion as of December 31, 1999.

> In telecommunications, we are rolling back the competitive progress made over the last ten years – disabling the enabling industry of economic growth when we need it most.[6]

Other articles go so far as to declare the entire competitive effort to be a failure and note that the RBOCs have slowly but steadily out-maneuvered their would be competitors. A 2001 article in The New York Times declared that the battle is over:

> Of the Baby Bell local phone carriers, once seven in number, three [sic] remain — Qwest Communications, SBC Communications and Verizon Communications — and they are by far the most powerful and important communications companies in the nation. The corporations once known as long-distance carriers, like AT&T, are shells of their former selves. … The Bells — the race's tortoises — have won.[7]

The potential danger to the nation's economy cannot be overstated. As is well recognized, the telecommunications industry is a critical component in the "high-tech engine" that has propelled our economy forward over a period longer than any other in modern times. That "engine" is now at risk of being usurped -- as a natural result of the corporate quest for profit maximization -- by a small group of very powerful companies: the RBOCs. As Wired magazine notes in yet another article on the demise of the competitive telecommunications industry:

> The Bells own 88 percent of the local lines in the US and upgrade on their own terms – conveniently, after most of their competitors have died off.[8]

V. NEED FOR REGULATORY OVERSIGHT

Whatever may be the merit of these somber prognoses, the fact remains that the competitive telecommunications industry is struggling to survive. In the war of attrition waged by the RBOCs against their competitors in the market place, in the U.S. Congress, the courts, and before regulators, it has not gone well for the CLEC industry and the financial community knows it. Regulatory policies are a critical component of the overall landscape, and it is most important that regulators stand firm -- now more than ever -- against all attempts on the part of the ILECs to raise barriers to entry any further. Unfettered access to the critical network elements required to provision competitive local exchange service is required at just and reasonable cost-based rates if the CLEC industry is to survive and present consumers with a sustainable alternative to the incumbent LEC.

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6 Brian Adamik, Yankee Group, *The Death of Competitive Telecom?* CBS MarketWatch, May 3, 2001.

7 Seth Schiesel, *Sitting Pretty: How Baby Bells May Conquer Their World*. The New York Times, Money&Business, Section 3, page 1. Sunday, April 22, 2001.

8 Frank Rose, Telechasm: *Can we get to the future from here? First we have to get telecom out of the Stone Age*. Wired, May 2001, page 131.

ATTACHMENT 1

COMPARISON OF MARKET CAPITALIZATION